No. 12206

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

GEORGE T. GOGGIN, Receiver, etc.,

Appellant,

vs.

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,

Appellee.

APPELLEE'S BRIEF.

SAMUEL B. STEWART, JR.,
HUGO A. STEINMEYER,
ROBERT H. FABIAN,
650 South Spring Street, Los Angeles 14,
Attorneys for Appellee.

The Myers Legal Press, Los Angeles. Phone VAndike 9007.

TOPICAL INDEX

TABLE OF AUTHORITIES CITED

CASES PAGE

TREATISES

STATUTES

No. 12206

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

GEORGE T. GOGGIN, Receiver, etc.,

Appellant,

vs.

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,

Appellee.

APPELLEE'S BRIEF.

I.

Statement of the Case.

This is an appeal from an order of the District Court approving an order of the Referee overruling the objections of Appellant, as Receiver, to the claim of Appellee filed in the Chapter XI Bankruptcy proceedings of Salsbury Motors, Inc.

Appellee's claim showed that at the time of filing the Debtor's petition Appellee was in possession of certain notes, drafts and collection items upon which it asserted a banker's lien [Tr. 15] and that it had converted those items into money and applied the proceeds to the unpaid indebtedness of the Debtor [Tr. 15, 60, 87]. The order

allowed the claim for $601,482.80 and directed that the net proceeds of the collection items and the sale of the real estate security should be applied in reduction of the claim.

The statement of the case appearing in Appellant's Opening Brief (App. Br. pp. 3-10) is substantially correct with two exceptions to which we will refer briefly.

First, Appellant says that the notes and drafts were deposited with the Appellee bank "for collection only." The evidence shows that these items were deposited for "collection and credit" to the depositor's account when the collections were completed [Tr. 76]. This is important because under the cases hereinafter cited it will appear that the obligation to credit the proceeds when collected is an indication that the depositor intended to create the debtor-creditor relationship.

Second, Appellant states in various places in the opening brief that Appellee bank extended no credit upon the faith of the notes and drafts in its hands for collection (App. Br. pp. 15, 22) and that it was stipulated that no such credit was extended (App. Br. p. 29). The stipulated fact is that no immediate credit was given by Appellee to the *deposit accounts* of the debtor upon the deposit of the collection items [Tr. 76]. This, of course, is entirely different from the assertion that no credit was extended, *i. e.,* no loan made to the debtor upon the faith of the notes and drafts deposited for collection. The general course of dealing hereafter discussed will indicate that under the authorities there would be a presumption that general credit was extended to the debtor upon the basis of that course of dealing.

II.

Summary of Argument.

We believe that it will facilitate an understanding of the issues in this appeal for Appellee to set forth the legal propositions and authorities which clearly demonstrate the correctness of the ruling of the District Court and the Referee, and in the course of that argument, to point out the erroneous conclusions asserted in Appellant's Opening Brief. These issues and authorities will, therefore, be discussed under the following subjects:

POINT ONE: The Court below correctly ruled that Appellee was entitled to retain the collection items and the proceeds thereof under its general bankers' lien.

1. The facts are squared within the definition of a banker's lien defined in California Civil Code, Section 3054.
2. The decisions uniformly support a general banker's lien under the facts shown.
3. Appellant's authorities are not applicable to the facts of this case.

(a) The application of Section 3054 of the California Civil Code must be determined by authorities subsequent and not prior to its enactment.

(b) Cases involving a pledge or other special agreement are not applicable to the facts of this case.

(c) The debtor had no power to terminate the agency for collection which was coupled with an interest.

POINT TWO: The Appellee was entitled to the proceeds of the collection items under the right of offset provided by Section 68(a) of the Bankruptcy Act.

POINT THREE: The Receiver's objections to Appellee's claim in the bankruptcy proceedings did not state facts sufficient to constitute a lawful objection to the claim.

III.

ARGUMENT.

POINT ONE.

The Court Below Correctly Ruled That Appellee Was Entitled to Retain the Collection Items and the Proceeds Thereof Under Its General Banker's Lien.

1. The Facts Are Squarely Within the Definition of a Banker's Lien Defined in California Civil Code, Section 3054.

The facts were all stipulated and for the purpose of the discussion of this point may be briefly stated as follows: At the date of filing the petition, the Debtor was indebted to Appellee in the aggregate sum of approximately $601,000.00 [Tr. 70, 77]. On that date the Appellee held in its hands notes and drafts accompanied by order bills of lading drawn on various purchasers in various places in the United States which had been deposited with Appellee in the regular course of business for collection and credit to the commercial bank account of the debtor when the proceeds of the collection had been received [Tr. 71, 76]. No immediate credit was made to the deposit accounts of the debtor upon the deposit of the collection items, nor were they in any way pledged to secure the indebtedness of the debtor [Tr. 76].

It would be difficult to state a clearer case in which a banker's lien might apply. Section 3054 of the Civil Code of California provides:

> A banker has a general lien, dependent on possession, upon all property in his hands belonging to a customer, for the balance due to him from such customer in the course of the business.

Every single element of the banker's lien provided for by the code section exists in this case. The collection items certainly belonged to the debtor and constituted property of the debtor. Furthermore, they were property of the debtor *in the hands of Appellee* at the time of filing the petition. It is so stipulated. The collection items had been deposited with the bank in the ordinary course of business between the debtor and Appellee. The evidence shows that during 1946, collection items so deposited averaged from $40,000 to $50,000 a month and during 1947 averaged about $150,000 a month. More than $1,300,000 in collection items had been deposited with the bank for collection and credit to the debtor's account. This clearly indicates a course of business extending for a period of almost a year and a half. There is no contention that the particular items which were in Appellee's possession at the date of filing the petition in these proceedings had been placed with the bank on any basis different from any of the other collection items which had been handled during the period.

It is conceded that on the date of filing the petition the debtor was indebted to Appellee in a sum in excess of $600,000. All of the elements giving rise to a banker's lien as specified in the code section are, therefore, clearly present.

2. The Decisions Uniformly Support a General Banker's Lien Under the Facts Shown.

The right of a bank to a lien upon property of a debtor in its possession is not only provided by Civil Code, Section 3054, it is well recognized by the decisions of the courts of this state. The most recent decision upon this point is that of *Gonsalves v. Bank of America,* 16 Cal.

2d 169, 105 P. 2d 118 (1940), where at page 173 the Court said:

> To understand this exercise of the bank's right it is necessary to state briefly its nature. Section 3054 of the Civil Code provides: "A banker has a general lien, dependent on possession, upon all property in his hands belonging to a customer, for the balance due to him from such customer in the course of the business." The banker's lien described in this statute is, properly speaking, a lien on the *securities* such as commercial paper deposited with the bank by the customer in the course of business. The so-called "lien" of the bank on the depositor's *account* or funds on deposit is not technically a lien, for the bank is the owner of the funds and the debtor of the depositor, and the bank cannot have a lien on its own property. The right of the bank to charge the depositor's fund with his matured indebtedness is more correctly termed a right of setoff, based upon general principles of equity. (See *Pendleton v. Hellman Commercial T. & S. Bank,* 58 Cal. App. 448 [208 Pac. 702]; 11 Cal. L. Rev. 111, 112; 7 Cal. L. Rev. 341; 38 Harv. L. Rev. 800; Brown on Personal Property, p. 518.)[1]
>
> This right of setoff, however, is not limited in its exercise to the pleading of a counterclaim in an action. Despite the technical inaccuracy involved in calling it a lien, it is in the nature of a lien or security interest in the funds, similar to and enforceable in the same way as the lien against commercial paper. That is to say, it is enforceable by the bank's own act, without the aid of a court.

---

[1]Throughout this brief emphasis is added unless otherwise noted.

In *American Surety Co. v. Bank of Italy,* 63 Cal. App. 149, 218 Pac. 466 (1923), at page 156, the Court says:

> It is settled law, and, indeed, as above indicated, it is expressly so provided by the law of this state (Civ. Code, Sec. 3054, *supra*), that a banker has a lien upon and so is *vested with the right to appropriate any money or property in his possession belonging to a customer to the extinguishment of any matured indebtedness of such customer to the bank* to the full extent of the money or property so possessed, if necessary, and so far as it may go toward such extinguishment, provided, of course, that such property or money so deposited has not been charged, with the knowledge of the bank, with the subservience of a special burden or purpose, or does not constitute a trust fund, of which the banker had notice.

The authorities go further. They hold specifically that in the absence of some agreement to the contrary a bank is entitled to a banker's lien upon *collection items* consisting of notes, checks or drafts which have been placed in its hands for collection. This rule is firmly established in the law and is uniformly stated in all of the text books. Brief quotations from them will indicate its universal application.

7 *C. J.* 618:

> Where one who deposits paper with a bank for collection is indebted to the bank, the bank has a lien on the paper and the proceeds thereof for the amount of such indebtedness.

9 *Corpus Juris Secundum* 520:

> *Where one who deposits paper with a bank for collection is indebted to the bank, the bank has a lien on the paper and the proceeds thereof for the amount*

of such indebtedness and the right to set off any matured debt against such proceeds.

8 *Zollman, Banks and Banking,* p. 429, Sec. 5661 (1936):

> In the absence of an express or implied agreement to the contrary, it acquires a lien as a matter of course through the express or implied contract made with the customer for the collection of his paper for the amount of its indebtedness on such paper and its proceeds, which lien is not waived by sending the paper to a correspondent bank for whose diligence and fidelity it is agreed that it should not be responsible.

6 *Mitchie, Banks and Banking,* p. 25, Sec. 19:

> It is a well-established general rule that a bank, receiving paper for collection has a lien thereon for a debt of the depositor of such paper to the bank, and is entitled to retain such paper as security for the debt, in the absence of a contract express or implied, to the contrary, and of notice of ownership in another.

7 *Am. Jur.* 453, Sec. 626:

> The general rule, where commercial paper is left with a bank for collection, is that the bank has a lien thereon for the general balance of account due it from the depositor.

In *Joyce v. Auten,* 179 U. S. 591, 45 L. Ed. 332 (1900), the Supreme Court of the United States said (p. 597):

> It is familiar law that a bank receiving notes for collection is entitled, in the absence of a contract, expressed or implied, to the contrary, to retain them as security for the debt of the party depositing the notes. 1 Jones, Liens, 2d ed. Sec. 244; *Bank of the*

Metropolis v. New England Bank, 1 How. 234, 239, 11 L. ed. 115, 116; *Reynes v. Dumont,* 130 U. S. 354, 391, 392, 32 L. ed. 934, 944, 9 Sup. Ct. Rep. 486.

This Court itself has had occasion to construe a statute of the State of Idaho which is in language identical to Section 3054 of the California Civil Code. In the matter of *In re Gesas,* 146 Fed. 734 (C. C. A. 9, 1906), the Court was considering the general law on banker's lien and in particular the proper construction of Section 3448, Rev. Stats. of Idaho (1887), which provided:

> A banker has a general lien dependent on possession, upon all property in his hands, belonging to a customer, for the balance due to him from such customer in the course of the business.

The opinion stated the general law upon the subject and quoted from *Reynes v. Dumont,* 130 U. S. 354, 32 L. Ed. 934 (1889) (cited App. Br. pp. 33, 42), and distinguished that case in the following language (p. 736):

> Those rulings are based upon the general law upon the subject or upon special statutes. It may be doubted that each of these principles is involved in the Idaho statute. It says that the lien is dependent upon possession by the banker of any of his customer's property. The debt or loan may be made without the possession or promise of possession of any of the customer's property and in no way be made upon its credit; but, when such property comes into the possession of the banker, his lien immediately attaches. An exception is when possession is given for some special purpose the property can be applied only to that purpose. Reynes v. Dumont, *ante,* and Armstrong v. Chemical Nat. Bank (C. C.) 41 Fed. 234, 6 L. R. A. 226. But I think this statute limits the matters referred to therein to those which occur

> in the usual course of banking business. While it says all property of the customer, it means all such property as in the usual course of banking business banks are in the habit of dealing in, or in taking on deposit, or for collection, or otherwise, such as notes, bonds, stocks, and other choses in action, the possession of which is consistent with the usual course of banking business and which the bank can conveniently have. I doubt that it applies to the possession of stocks of merchandise or of live stock or of other cumbersome property which cannot conveniently pass into the actual possession of the bank, or such as it does not usually deal in.

It is true that the exact facts were not involved in the *Gesas* case and the Court there held that the facts did not justify the application of a banker's lien. The Court's construction of the statute which is exactly applicable to the facts of the case at bar is, however, reasonable and convincing.

A case that did involve the exact facts of the present case is the matter of *In re Farnsworth,* Federal Case No. 4673, 5 Biss. 223 (1873). In that case Farnsworth and Co. were indebted to the bank on a promissory note. In the usual course of business Farnsworth and Co. drew drafts on their customers and deposited them in the bank for collection. At the time of bankruptcy a number of these drafts were in the possession of the bank and were collected after bankruptcy. There, also, the proceeds of the drafts when collected were credited to the firm's deposit account. In that case, the Court held that the bank was entitled to the proceeds of the drafts collected after bankruptcy on two grounds: First, by reason of its banker's lien, and, second, because the transactions constituted mutual debits and credits to which the right of offset applied.

A more recent case is that of *Kane v. First Nat. Bank of El Paso, Tex.*, 56 F. 2d 534 (C. C. A. 5, 1932), where the Court said (p. 537):

> We therefore face the question whether a bank having checks for collection and credit, on learning of the customer's insolvency, may collect and retain the proceeds as against a bankruptcy within four months. The question was affirmatively answered in 1873, *In re* Farnsworth, 8 Fed. Cas. page 1056, No. 4673, the right being put upon the banker's lien. There the drafts were collected after the bankruptcy. *The banker's lien extends not alone to the application of moneys and cash balances, but to the retention and collection of commercial paper and securities which have come into the banker's hands in the ordinary course of business and with no agreement to the contrary.* 7 C. J., Banks, Section 285; 3 R. C. L., Banks, Sections 213, 215; Bank of the Metropolis v. New England Bank, 1 How. 234, 11 L. Ed. 115; Joyce v. Auten, 179 U. S. at page 597, 21 S. Ct. 227, 45 L. Ed. 332. It arises as a matter of course unless rebutted. Reynes v. Dumont, 130 U. S. at page 391, 9 S. Ct. 486, 32 L. Ed. 934. In Davis v. Bowsher, 5 Term 488, it is said: "The rule is that no person can take paper securities out of the hands of his banker without paying him his general balance unless such securities were delivered to him under a particular agreement which enables him so to do." The lien of course survives the customer's insolvency. Joyce v. Auten, *supra*. Such a lien the appellee bank had on the checks in its hands for collection, for there is nothing in the deposit agreement which negatives it.

We respectfully submit that the rule is so firmly established in the law that there can be no doubt of its applicability to the facts of the present case.

ther, the very element that prevented the banker's lien in those cases was that the *forwarding* bank held the item for collection merely and consequently *had no title.* The facts were not within the provisions of Section 3054. Here the debtor against whom the lien is asserted *was* the owner of the items.

In *Brandao v. Barnett,* 3 C. B. 519, 136 Eng. Rep. 237 (1846), the securities were deposited in a box which was kept at the bank. The bank from time to time entered the box at the customer's request to collect interest or exchange securities. The securities were not deposited with the bank in the usual course of business transactions and the Court took the view that the arrangement precluded the exercise of a banker's lien upon them.

Counsel also argues that where paper is deposited with a bank for collection, the relationship between the parties is that of principal and agent, and title to the paper does not pass to the bank. We have no quarrel with this statement of the law. It is one of the essential elements of our case that the property upon which the lien is asserted be property of the depositor. At the time of filing the petition the collection items certainly belonged to the debtor. However, when the collection of the paper is completed, the agency terminates and the bank becomes the owner of the money and the debtor-creditor relationship arises. *Jennings v. United States Fidelity & G. Co.,* 294 U. S. 216, 55 Sup. Ct. 394, 79 L. Ed. 869, 872, 99 A. L. R. 1248 (1934); *Kane v. First Nat. Bank of El Paso, Tex.,* 56 F. 2d 534 (C. C. A. 5, 1932). But there is nothing in Section 3054 which precludes the application of a banker's lien upon property which belongs to the depositor. On the contrary, the lien can only apply upon property which

does belong to the depositor. Obviously, the bank could not have a lien upon its own property.

It is clear, of course, that in order for a banker's lien to exist there must be a matured indebtedness from the customer to the bank. If there were no indebtedness there would be no reason for a lien. The argument that credit must be extended upon the particular items upon which the lien is asserted is not supported in reason or by the authorities. Appellant quotes from numerous sources to the effect that a banker's lien ordinarily attaches in favor of the bank upon securities of a customer deposited in the usual course of business "for advances *supposed to have been made* upon their credit." The very words quoted so often "supposed to have been made" indicate not that advances must be made but rather that there is a presumption that "advances have been made upon the credit of the securities in the bank's possession." An insight into a possible reason for this presumption may be found in American Jurisprudence, 7 Am. Jur. 452, in which the author states:

> The reason given for allowing the lien is that any credit which a bank gives by discounting notes or allowing an overdraft to be made is given on the faith that money or securities sufficient to pay the debt will come into the possession of the bank in the due course of future transactions.

Whatever may have been the historical reason for the banker's lien, it is a part of the substantive law, recognized by statute and court decisions and applicable to the facts of this case without the limitation that Appellant has sought to attach to it.

(b) Cases Involving a Pledge or Other Special Agreement Are Not Applicable to the Facts of This Case.

We do not question the rule that where property is *pledged to secure a specific debt* it cannot be held under a banker's lien as security for some other debt. The reason for this is that when the property is pledged for a specific debt, there is an agreement implied from the circumstances or the nature of the transaction that it shall not be held for any other debt. The rule is stated and discussed in an annotation in 68 A. L. R. 912 as follows:

> But, if collateral is pledged for the security of a particular, specified debt, the pledgee has no lien on the collateral pledged for any other or subsequent debt contracted by the pledgor to him, without an agreement to that effect, either express, or implied from the nature or circumstances of the transaction.

In this annotation the authors in support of the rule cite *Bell v. Bank of California,* 153 Cal. 234, 94 Pac. 889 (1908), and *Berry v. Bank of Bakersfield,* 177 Cal. 206, 170 Pac. 415 (1918), as authorities for the rule in the State of California. These are the very cases cited by counsel for the Appellant in support of his contention that the right of a banker's lien has been limited in some circumstances. These cases have no bearing upon the facts involved here. In the instant case, the collection items were not pledged to secure any indebtedness, nor were they in the possession of the bank as an escrow holder or trustee [Tr. 76]. *They had been deposited with the bank in the usual course of business for collection and credit to the debtor's commercial deposit account.* Cases such as *Anglo-Cal. B. v. Grangers' B.,* 63 Cal. 359 (1883), or

Berry v. Bank of Bakersfield, supra, or *Della v. The Home Bank of Porterville,* 105 Cal. App. 106, 286 Pac. 1064 (1930), therefore have no application to the facts involved in the present proceeding.

An analogous situation is found in the decision of this Court in the case of *Wells Fargo Bank & Union Trust Co. v. McDuffie,* 71 F. 2d 720 (C. C. A. 9, 1934). The facts in that case may be briefly stated as follows: The Wells Fargo Bank had a credit arrangement with Richfield Oil Company for the purchase of acceptances consisting of foreign bills of exchange accompanied by shipping documents. The acceptance agreement provided that the bank should have a lien on the drafts not only for the liability under the acceptance agreement, but for all indebtedness of the Richfield Oil Company to the bank. In addition to the drafts taken under the acceptance agreement there were two foreign drafts deposited with the bank for collection *which were not pledged* in any way but which *were* in the bank's possession at the time of the receivership. The question at issue was whether or not the bank had a general banker's lien on these foreign drafts which were in its possession and not covered by the acceptance agreement. Upon this point the Court said at page 727:

> The situation with reference to the bills of exchange for $23,532.08, drawn on Birla Bros., and the one for $1,245.11 drawn on Valezquez, is somewhat different. They were not held in a special sense "as security for acceptances." *No credit had been extended on account of them, but the bank had a lien thereon for all sums due it which would include, of course, sums due it upon unpaid acceptances.*

One of the cases cited in the argument of counsel for the Receiver is *Powell v. Bank of America,* 53 Cal. App. 2d 458, 128 P. 2d 123 (1942). In view of the difference in facts in that case from the present one it is actually authority for Appellee's position. In stating the circumstances in which a banker's lien could *not* apply the Court indicated that in circumstances such as here the right to a general banker's lien does exist. In the *Powell* case a person not a customer of the bank delivered certain warehouse receipts to the bank under written instructions to deliver them to certain grain dealers upon collection of the sum of $2,186.89. The instructions provided that from that amount they should remit $240.09 to the person forwarding the item and the balance "to be remitted direct to L. M. Miller, Knights Landing, California." The bank attempted to hold the funds that were to be remitted to Miller under a claimed banker's lien in order to apply them upon an outlawed judgment that the bank held against Miller. The Court pointed out in its opinion that Miller, the owner of the money, *was neither a customer nor a depositor of the bank* and there was no possible basis upon which it could be said that the bank was authorized to deposit the money in the bank to the credit of L. M. Miller or to create a relationship of debtor and creditor between them.

In the present case we have the exact opposite situation. The debtor in these proceedings was a borrowing customer and a depositor of the bank, and it specifically directed that the proceeds of the collections should be credited to the debtor's commercial deposit account.

(c) The Debtor Had No Power to Terminate the Agency for Collection Which Was Coupled With an Interest.

The stipulated facts show that after the filing of the petition the debtor attempted to terminate the agency of the bank to collect a promissory note signed by the Jacques Power Saw Company of Denison, Texas, and to collect the proceeds of that note direct from the maker. Clearly, the debtor had no right to possession of the collection item. The statute provides that the bank shall have a lien upon all property in its hands to secure the indebtedness owing to the bank. There could be no effective lien if the bank's customer could at will demand return of his property without payment of the indebtedness. Such a construction would negative the statute itself. In *First Nat. Bank of Corona v. Coplen,* 39 Cal. App. 619, 179 Pac. 708 (1919), the Court said (p. 620):

> That "a banker has a general lien, dependent on possession, upon all property in his hands belonging to a customer, for the balance due to him from such customer in the course of the business," is declared by section 3054 of the Civil Code; and that a bank may, in the exercise of the right to enforce such lien, appropriate the money in its possession belonging to a customer in the extinguishment of the customer's matured indebtedness, is declared in the case of *Melander v. Western Nat. Bank,* 21 Cal. App. 462 [132 Pac. 265], and cases cited therein. To hold the right to so apply the deposit is *dependent upon the consent of the depositor would destroy* the right given.

Obviously the debtor could not by its mere assertion of the right to receive the collection deprive the bank of its banker's lien upon the notes held in the hands of the bank at the time the petition was filed.

The same rule is stated in *Kane v. First National Bank of El Paso, Tex., supra.* The Court said (p. 538):

> Without any new act or transaction between the depositor and the bank, but the natural and legal fruition of the contracts of deposit from which neither party could have withdrawn without the consent of the other, collection was made and *ipso facto* the amount went to the credit of the depositor, and the bank became a debtor by general deposit. The result takes its character as preferential or not from the intention with which the contracts were made that produced it. The lien is of importance *only to show that the collection could not have been withdrawn by the depositor in the meanwhile.* Thereafter the bank was within its rights in closing the account and refusing to permit further checking on it.

The letter attempting to terminate the agency for the collection of the Jacques Power Saw Company note was clearly ineffective for any purpose. For the same reason, the Receiver's demand could not be effective to destroy Appellee's lien.

POINT TWO.

The Appellee Was Entitled to the Proceeds of the Collection Items Under the Right of Offset Provided by Section 68(a) of the Bankruptcy Act.

We believe that the authorities which have heretofore been cited, conclusively show the correctness of the judgment of the Court below that Appellee was entitled to hold the collection items and the proceeds thereof under its general banker's lien. Notwithstanding those decisions, however, there is another basis upon which the bank is entitled to retain the proceeds of the collections which is equally supported by the law and the decisions and that is the right of setoff provided by Section 68(a) of the Bankruptcy Act. (11 U. S. C. 108(a).)

We have no quarrel with the principle that the right of setoff cannot exist where the money is held by a bank in the capacity of a trustee or escrowholder nor obviously could it be asserted in a case in which the bank or person seeking to establish the setoff had received or was attempting to establish a preference within the meaning of the provisions of the Bankruptcy Act. This is the extent of the holdings in the cases cited by counsel for Appellant, such as, *Continental Nat. Bank v. Moore,* 299 Fed. 270, 272 (C. C. A. 9, 1924); *Union Bank & Trust Co. v. Loble,* 20 F. 2d 124 (C. C. A. 9, 1927), and other cases.

It is clear that in the instant case the collection items were not held by the bank as a trustee or escrowholder. Neither is there any allegation in the pleadings that the Appellee secured any manner of a preference either by

offsetting the deposit accounts or by its retention of the collection items.

It is likewise conceded that the right of setoff cannot apply unless there are mutual debts and credits and that the relation ordinarily existing between a bank and its customer when the bank has received items for collection is that of prinicpal and agent. As we have pointed out previously, however, the relation of principal and agent exists until collection of the items is effected and at that time the relation of debtor and creditor arises (*Jennings v. U. S. Fidelity & G. Co.,* 294 U. S. 349, 79 L. Ed. 869, 872, 99 A. L. R. 1248 (1934); *Kane v. First Nat. Bank of El Paso, Tex.,* 56 F. 2d 534 (C. C. A. 5, 1932).

Section 68(a) of the Bankruptcy Act (11 U. S. C. 108(a)) provides as follows:

> Section 68. *Setoffs and Counterclaims.* (a) In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid.

There would be no possible question of the setoff in this case were it not for the fact that the proceeds of the collection items were not in fact received by Appellee until after the commencement of these proceedings. Under the authorities, however, it is well settled that notwithstanding the fact that the proceeds were collected after bankruptcy, the rule of setoff provided by Section 68(a) applies.

The law as stated by the cases hereafter referred to is that when property has been deposited by a bankrupt with a creditor under such circumstances of dealings between the parties that *a conversion into money* is in the ordinary course of business the natural result of the transaction, the *obligation of the creditor* to convert the property into money and give credit thereon is a mutual credit in the bankrupt's favor which under 68(a) of the Bankruptcy Act is required to be offset against the indebtedness of the bankrupt to the creditor.

The evidence in this case shows that upon each of the collection items that were received by Appellee and were in the hands of Appellee on the date of filing the petition, the debtor had issued and Appellee had accepted instructions to credit the proceeds of said collections when received to the commercial account of the debtor [Tr. 76]. It was, therefore, an *express agreement* as to each item which imposed an obligation upon Appellee, first, to collect the item and, second, to create the relation of debtor and creditor by deposit of the funds to the general account of the debtor when collected.

The exercise of the right of offset as to the balances in the deposit accounts prior to the filing of the petition did not and could not from the nature of the transaction affect the contract of the bank to collect the notes and drafts in its possession and to credit the amounts thereof to the debtor's account even though they might be subject to immediate offset.

This obligation to collect and credit the account gives rise to the right of offset against an indebtedness of the debtor to Appellee under Section 68(a) of the Bankruptcy Act. This very point was decided by this Court in *Half Moon Fruit & Produce Co. v. Floyd,* 60 F. 2d 799 (C. C. A. 9, 1932). In that case the bankrupt before bankruptcy had consigned 75 carloads of melons to the Half Moon Fruit & Produce Co. and was indebted to that company upon an open account in substantial sums. Thereafter the melons were sold and the proceeds applied upon the indebtedness of the bankrupt. Part of the melons were sold after the creditor had actual knowledge of the bankrupt's insolvency. The consignee filed its claim against the bankrupt's estate upon which it gave credit upon the existing indebtedness for the proceeds of the sale of the 75 cars of melons. In that case the trustee objected to the allowance of the claim unless and until the claimant should relinquish $10,000 which it had received from the sale of the 75 carloads of melons belonging to the bankrupt which the trustee contended constituted a preferential payment. Although no claim of a preference is made in the present proceedings, in other respects the facts are practically identical with the *Half Moon Produce* case. This Court held the transaction did not amount to a preference and also held that the right of offset existed. The Court said (p. 802):

> *At the time of the consignment of melons by the bankrupt to the appellant, the appellant owed the bankrupt the duty of converting the melons into money for the account of the bankrupt, and it is this*

obligation of the consignee which the cases above cited held to be a credit in his favor to be offset against the credit of the consignee for moneys previously advanced, thus, to the extent thereof, canceling the mutual obligation or mutual credit.

As to the second proposition that the preferential payment cannot be set off against the debt upon which proposition the appellee cites Walker v. Wilkinson (C. C. A.) 296 F. 850, it is sufficient to point out that this assumption begs the question as to whether or not the payment is preferential. If the transaction were fixed by the dates of the consignment of the melons, there was no voidable preference under the law. This is what is contended for by the appellant and is well settled by the authorities. *The conversion of the goods* into money is a mere incident in the transaction.

In *Kane v. First National Bank of El Paso, supra,* the situation was likewise similar to the facts of the case at bar. In that case the bankrupt before bankruptcy had deposited certain checks to its deposit account with the bank for collection and credit to its deposit account. At the time the checks were left with the bank, the bank did not know that the depositor was insolvent, but it subsequently learned that before the checks were collected. Although upon the deposit, credit was given to the bankrupt's deposit account, it was specifically understood that the depositor had no right to draw against the funds represented thereby until the proceeds were collected. To that extent the case is no different from the case at bar

in which the collection items were deposited with a request that credit be given when the items were collected. There again the Court held, as we have indicated in a quotation from the opinion in an earlier part of this brief (*ante* p. 11), that the banker's lien attached not only to the collection item but to the proceeds of the collection and that when collected the amount of the collection *ipso facto* went to the credit of the depositor and thereupon the offset arose.

The application of the setoff to a situation of this kind is closely analogous to that which arises upon a secured claim. There the statute specifically requires that the securities shall be *converted into money* and the amount credited upon the creditor's claim.[2]

There, as here, the actual *amount* to be offset cannot be determined until after bankruptcy but it is required to be determined pursuant to the contract. Here the amount was determined by collection of the items pursuant to the contract of the parties. When collected, the amounts so collected necessarily were and should be applied in reduction of Appellee's claim against the estate of the debtor. We respectfully submit that the contract obligation to convert the collection items into money gives rise to the offset under the statute.

---

[2]Section 57(h) of the Bankruptcy Act (11 U. S. C. 93(h)) provides:

> The value of securities held by secured creditors shall be determined by converting the same into money according to the terms of the agreement pursuant to which such securities were delivered to such creditors, or by such creditors and the trustee by agreement, arbitration, compromise or litigation, as the court may direct, and the amount of such value shall be credited upon such claims, and a dividend shall be paid only on the unpaid balance. Such determination shall be under the supervision and control of the court.

POINT THREE.

The Receiver's Objections to Appellee's Claim in the Bankruptcy Proceedings Did Not State Facts Sufficient to Constitute a Lawful Objection to the Claim.

In the proceedings before the Referee, the Receiver caused an Order to Show Cause to be issued against Appellee to secure possession of the proceeds of the promissory note for $34,673.50, signed by the Jacques Power Saw Company [Tr. 37-38]. Appellee objected to the jurisdiction of the Referee by summary process to recover this note or the proceeds thereof [Tr. 40-41]. These objections were overruled by the Referee [Tr. 67] and the proceeding was consolidated with the objections of the Receiver to Appellee's claim. In its answer to the Receiver's objections Appellee likewise objected to the jurisdiction of the Referee [Tr. 58].

The Receiver's purported objections to the claim do not in fact state any legally sufficient objections. It is admitted that there was an indebtedness owing by the debtor to the Appellee in the sum of approximately $601,000.

It is admitted that Appellee was in possession of the collection items upon which it had asserted a banker's lien. The validity and amount of the indebtedness was not disputed nor was any question raised as to the sufficiency of the proof of the claim. Neither was there an allegation of any facts seeking to establish that Appellee had received a preference thus bringing the case within the provisions of Section 57(g) of the Bankruptcy Act. It is clear, therefore, that the Receiver's pleading was no more than an attempt to vest jurisdiction in the bankruptcy court of an action to recover possession of the property of the bankrupt which was lawfully in Appellee's

possession at the time of filing the petition. The authorities are legion that in the absence of consent the bankruptcy court has no jurisdiction by summary process to determine the title or right to possession of property which is in the possession of third persons at the time the bankruptcy petition is filed. Even where a preference has been obtained and we emphasize the fact that no preference has been claimed in this estate, the provisions of Section 57(g) of the Bankruptcy Act merely provide that a claim shall not be allowed unless the preference is surrendered. It does not give the bankruptcy court summary jurisdiction to recover the alleged preference and such a proceeding must be by plenary action.[3]

In Point Three of Appellant's Opening Brief (App. Br. p. 40) it is suggested that this being a Chapter XI proceeding, the ordinary right of a banker's lien or right of setoff does not necessarily apply. The only cases cited in support of this proposition are decisions rendered in Chapter X proceedings where the right of secured as well as unsecured creditors are affected and the statute even authorizes the creation of liens prior to existing liens. Chapter XI proceedings, on the other hand, relate only to an arrangement with unsecured creditors and there is nothing in the statute to give the Court jurisdiction over secured creditors nor to defer their security interests to other creditors.

Furthermore, this point was not raised in any of the pleadings in the Court below and we respectfully submit

---

[3]2 Collier, Bankruptcy (14th ed.), Par. 23.06, pp. 480, 481, 500.

that it is not of the character that may be raised for the first time on appeal. If the Court should be of the opinion that the matter deserves consideration we respectfully urge that Appellee be afforded an opportunity to enlarge the Record on Appeal to show that the plan of arrangement approved by creditors and confirmed by the Court below provided for a sale of all assets of the Debtor as a going concern, and that such sale has been consummated. The matter is therefore moot.

Conclusion.

The facts are simple and are all stipulated. At the filing of the petition Appellee held the collection items under a general banker's lien as security for an admitted indebtedness of over $600,000. Under the law and the decisions it was entitled to appropriate the items and the proceeds thereof to apply upon the indebtedness. This is in conformity with Section 57(h) of the Bankruptcy Act, and an application of the right of setoff required by Section 68(a) of that Act.

The Appellant has shown no facts nor cited any authorities giving him the right to recover the Appellee's security. The cases upon which he relies may be correct statements of the law applicable to the facts of those cases but they have no application to the facts of this case. Here the stipulated facts show that the collection items were in the bank's possession in the ordinary course of business extending over a long period of time, they were not pledged for any specific obligation nor held in escrow or trust for any special purpose. They were deposited

for collection and credit to the commercial deposit account of the debtor in the normal course of business. Under these facts it is respectfully submitted that the cases herein cited show that the right of the banker's lien applies and that Appellee's claim was filed and the security converted to money in conformity with the requirements of the Bankruptcy Act.

It is respectfully submitted that the decision of the District Court should be affirmed.

Samuel B. Stewart, Jr.,
Hugo A. Steinmeyer,
Robert H. Fabian,
Attorneys for Appellee.